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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 245.

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birin, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief of Respondents United States Pictures, Inc. and Milton Sperling in Opposition to Petition for Writ of Certiorari.

OLIVER E. SCHWAB,
HAROLD S. KANT,
141 El Camino Drive,
Beverly Hills, California,
Counsel for Respondents, United States Pictures, Inc. and Milton Sperling.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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In setting forth the Questions alleged to be presented and in his Statement of the Case, Petitioner has intermingled, in what we believe to be a misleading manner, certain claims decided adversely to Petitioner in the District Court *and not contested in* [*appealed to*] *the Court of Appeals*, with other distinct claims also decided adversely to Petitioner in the District Court and which were appealed, unsuccessfully, to the Court of Appeals. Because of this confusion and because we

take serious issue with Petitioner's presentation of the facts, these Respondents respectfully deem it necessary to set forth their own Statement of the Facts and Questions Presented."

Questions Presented.

It is respectfully submitted that there are no questions presented of sufficient dignity or magnitude to justify review by this Honorable Court. The sole question presented is one which, because it presents no federal issues, this court has by tradition and policy deferred to the determination of the proper Court of Appeals, to wit:

> In this shareholder's derivative action, did the Court of Appeals err in affirming the District Court's determination under relevant *state* law that the "Business Judgment Rule" governed, viz. that claims based on certain alleged accounting irregularities could not be maintained where the directors of the corporation decided, in the exercise of their independent business judgment, in good faith, and without fraud or domination of any person or persons whatsoever, that it was not in the best interest of the corporation to prosecute such claims?

Statement of the Case.

A. General History of the Case.

This is a stockholders' derivative suit which Petitioner brought for the alleged benefit of Respondent Warner Bros. Pictures, Inc., a corporation ("Warner Bros."). The action was commenced in 1948. Petitioner's alleged cause of action then was that a contract between Warner Bros. and Respondent United States Pictures, Inc. ("United"), for the production

distribution of a series of motion pictures, had been wrongfully entered into for the purpose of unjust enrichment of United and Respondent Milton Sperling ("Sperling"), at the expense of Warner Bros. After a period of trial in 1953, the District Court realigned the parties in the first cause of action and found that diversity jurisdiction was absent. It dismissed the first cause of action for that reason, and dismissed the second cause of action for lack of equity as the parties then stood. The third cause of action had previously been dismissed pursuant to stipulation.

On appeal to the United States Court of Appeals for the Ninth Circuit, that Court affirmed the District Court's judgment on the first cause of action, but remanded the case to the District Court for further proceedings on the second cause of action.

This Honorable Court granted certiorari and, by a divided Court, held that diversity jurisdiction existed on the first cause of action.

The case came on for further trial of the *non federal* issues in the District Court in 1958, at which time, by stipulation, the testimony and documentary evidence submitted in the 1953 trial was deemed part of the record on the merits for the 1958 trial. The 1958 trial plus the 1953 trial thereof, therefore involved an aggregate of approximately 25 days of hearing, and hundreds of exhibits introduced by Petitioner in addition to a goodly number of Respondents.

In December, 1958, the District Court handed down its decision, ruling on the *merits* against Petitioner on the first cause of action as contained in its complaint in 1958. However, in 1958, the District Court had admitted all testimony presented by Petitioner at the

actions between Warner Bros. and United right down to trial; and the District Court ruled that, under Rule 54(c), Federal Rules of Civil Procedure, the Court must consider all such evidence introduced at the 1958 trial as though the complaint had been amended to include allegations of such evidence. Based on this 1958 evidence, Petitioner for the first time advanced several completely new postverted claims, all inmisically of an accounting nature, involving alleged misinterpretations in the operation of the contract which Petitioner claimed were detrimental to Warner Bros. As to these new accounting claims, the District Court decided that, under the substantive law governing the case, the "Business Judgment Rule" applied; that the Board of Directors of Warner Bros. had, in the honest and free exercise of its business judgment, determined that it was not in the best interests of Warner Bros. to maintain such claims. Accordingly, the District Court ruled against Petitioner on such new claims. Under the Business Judgment Rule, the District Court further ruled that such judgment on these claims would not be *res adjudicata* in any case that neither United nor Warner would subsequently be foreclosed from asserting any accounting claims against the other during or after the remaining term of the agreement between Warner Bros. and United.

On appeal to the United States Court of Appeals for the Ninth Circuit, the decision of the District Court was unanimously affirmed in all respects.

B. Issue Before This Court.

It is clear that the Petitioner's sole objective in the entire controversy as it was presented before this Court for ten years, from the filing of the complaint

in December, 1948, until the commencement of the second hearing in April 1958 to test the validity of the basic production distribution agreement entered into between Warner Bros. and United in 1945 and the various supplemental and amendatory agreements thereto.

At the close of trial in 1958, the District Court adjudged, *on the merits* that all such contracts, amendments, and agreements entered into and introduced in evidence up to the close of trial in 1958 were not only "*made and entered into in good faith and without fraud*" but "*were fair and reasonable*" [Find. XXV, R. 612-613].

Petitioner, however, in the Court of Appeals and in his Petition for Certiorari, sought to convey the impression that the District Court had decided the entire case on the Business Judgment Rule and, accordingly, that the District Court had entirely deprived the Petitioner of a decision on the *merits*".

Since Petitioner had, quite apparently by invention, cast the issue on appeal as one of Business Judgment Rule only, his appeal to Court of Appeals raised no issue as to the propriety of the findings, conclusion and judgment of the District Court on the broad and sweeping issues disposed of on the merits. Moreover, no such issue is raised here. No matter, the record created, for the most part by Petitioner, throughout 25 days of trial and, hundreds of exhibits, overwhelmingly supports the District Court's findings, conclusions and judgment on the merits, as affirmed by the Court of Appeals, and they would in any event be beyond any realistic challenge.

Accordingly, the single question is whether the District Court, in full view of the substantive state law of

plicable to the accounting issues newly raised in 1958, properly applied the Business Judgment Rule.

For purposes of clarity, however, a concise statement of all the basic facts is presented herewith.

C. The Facts.

Petitioner's complaint herein, and Petitioner's position throughout ten years of litigation, were all one heinous charge that Sperling, because he was the son-in-law of one of the four brothers who had founded Warner Bros., had allegedly been given a contract with Warner Bros. "illegally, wrongfully and in bad faith," and that the directors of Warner Bros. misappropriated assets of Warner Bros. in order to enrich Sperling; that this injury to Warner Bros. was done through conspiracy with and domination by H. M. Warner, Jack Warner and Albert Warner—men whose lifelong careers had been devoted to the development of the motion picture industry, and, in particular, to the successful development of Warner Bros.

The facts are completely to the contrary, and are virtually without contradiction in the record.

The Original Contract.

Production-distribution agreements with independent producing corporations have been common in the motion picture industry. Warner Bros. has entered into many of them, both before and after the Warner-Unity agreement in 1945. (See Defs. Exs. V-1 to V-15.)

The original contract speaks for itself; it has been set out on the record from the beginning (Pltf. Ex. 1). The Delaware Court has examined the contract and

found it "fair and reasonable" [Find. XXV, R. 612-613].

The overall benefits to Warner Bros. from the contract and the additions and supplements thereto have been tremendous. The record shows without contradiction [Defts. Ex. Q] that Warner Bros. actually received to August 31, 1957, from the first ten pictures produced by United under the Warner-United agreement total benefits of $13,001,504. These include Warner Bros. distribution fees, Warner Bros. overhead received, Warner Bros. share of profits and other items on the ten pictures. The total estimated benefits to Warner Bros. from the ten pictures, from ultimate final world gross, is calculated at $14,955,000. [Defts. Ex. R.]

> "There is no doubt that the production contract with United States Pictures, Inc. proved its operation to be very lucrative to Warner Bros. Pictures, Inc." [Opinion of the Court of Appeals, Appendix B.]

The Warner Bros. Board.

The Warner Bros. Board of Directors which passed upon the original contract consisted of 11 members (one vacancy existed which was filled in November 1945); three of them were Harry, Jack and Albert Warner. [R. 27.]

Neither Harry Warner nor Jack Warner attended or participated in the meeting of September 25, 1945 at which the contract drawn was first mentioned [R. 503-504], nor that of September 28, 1945 at which it was approved. At the meeting of September 28, 1945 director Stanley Fridman explained to the Board in detail the terms of the contract [R. 453-460]. The

contract was unanimously approved [Pltf. Ex. 18, R. 605-606].

Testimony of every one of these directors is in the record. Of the 7 directors (other than Harry, Jack and Albert Warner), Petitioner took the depositions of five; all of such depositions were introduced in evidence and most all of such depositions were read into the record by Petitioner [Carlise, Pltf. Ex. 113, R. 179-196; Catchings, Pltf. Ex. 116, R. 243-269; Guggenheimer, Pltf. Ex. 117, R. 270-285; Perkins, Pltf. Ex. 119, R. 293-308; Wolf, Ex. 118, R. 285-292]. Petitioner requested Director Stanleigh Friedman to testify at the trial and he did so [R. 443 *et seq.*]. Director Schneider also testified [R. 507 *et seq.*].

In 1953, the District Court found as follows:

> "That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother, Albert Warner, are but three; that the contract in controversy was made and entered into in good faith and without fraud; that in approving and authorizing the contract, the officers and Board of Directors acted in good faith and exercised their independent business judgment." [Find. IV, R. 74-75].

The finding that the directors were not dominated by Harry Warner, or his brothers, and that they acted in good faith, was affirmed by the Court of Appeals in the first appeal and such finding was not affected by the reversing decision of this Honorable Court. No new evidence with respect to domination or the good faith

that directorate has been introduced since this case last appeared in this Court. Moreover, the District Court, at the 1958 hearing, made a similar finding to the 1953 finding quoted above [Find. II, R. 602], and such finding was affirmed again by the Court of Appeals [Appendix B].

The 1947 Supplemental and Amendatory Agreement.

In 1947, after three pictures had been produced under the original contract, Warner Bros. and United entered into a supplemental and amendatory agreement [Pltf. Ex. 4]. Warner Bros. desired more pictures; the 1947 amendment established a new group of pictures called "additional pictures," and provided for the production of four such "additional pictures" [Pltf. Ex. 4].

The District Court examined this contract in 1953. No new evidence in support of plaintiff's attack on the 1947 contract was introduced at the 1958 trial.

The District Court has found the 1947 contract fair and reasonable [Find. XXV, R. 612-613], and the Court of Appeals affirmed this finding [Appendix B].

Later Supplementary and Amendatory Agreements.

The original contract, entered into in 1945, called for six pictures. By the date of the 1958 trial, United had actually produced 11 motion pictures for Warner Bros. (the 11th picture had just gone into release in 1958).

These added pictures were provided for in a number of supplementary and amendatory agreements entered into (in addition to the 1947 agreement) between Warner Bros. and United over a period of years prior to the time of the 1958 trial; these agreements increased

the number of pictures and extended the term of the Warner-United agreement.

The District Court found that each and all of these supplemental and amendatory agreements were "fair and reasonable" [Find. XXV, R. 612-613], and the Court of Appeals affirmed this finding (Appendix B).

Petitioner's Accounting Claims, Newly Raised in 1958 —The Only Claims Presently Urged Upon This Court.

As stated hereinabove, based on evidence at the 1958 trial, Petitioner made several new alleged claims, mainly that certain accounting transactions were violations of the agreements between Warner Bros. and United, as Petitioner sought to interpret them.

Although these claims were not contained in the complaint, the District Court ruled that Petitioner had the right to advance them, under Rule 54(c) of the Federal Rules of Civil Procedure [Appendix A].

Under the circumstances, the District Court suggested to the parties that it might be advisable, since these alleged accounting claims were just newly made and had not been prescribed to the Warner Bros. Board of Directors, to make such a presentation to the Warner Bros. Board [R. 780]. It should be particularly noted that Petitioner's repeated protestations in his Petition that he was prohibited by the District Court "to go to the Warner Bros. Board of Directors after ten years" are the grossest distortion of the facts, the District Court could not have made the suggestion earlier because Petitioner himself had not presented such claims earlier. Indeed

if the District Court had required Petitioner to file a supplemental complaint based on the new purported charges, as it might well have done, then Petitioner would have been compelled to present these claims to the Warner Bros. Board under the provisions of Federal Rules of Civil Procedure, Rule 23(b) [Appendix A] unless Petitioner could have advanced, which is highly doubtful, compelling reasons for not doing so.

In any event, the District Court did not compel Petitioner to make such submission, but left it to Petitioner to decide whether he would elect to make such submission [R. 786]. Petitioner elected to and did make such submission; the Warner Bros. Board of Directors caused an independent investigation to be made of Petitioner's claims; thereafter the Warner Bros. Board of Directors passed a resolution that "it is not to the best interests of the Corporation (Warner Bros.) to lend its sanction" to the proceedings in this case "either as included in the present complaint or in said complaint if amended to include any of the matters set forth in the letter of October 16, 1958" (which letter contained Petitioner's submission to the Warner Bros. Board) [R. 615-616].

The District Court found that the Warner Bros. Board of Directors, in considering and passing on said matters, "acted in good faith, without fraud, coercion or domination of any person or persons whatsoever"; that the directors "intended to and did act in the interests of Warner Bros. and exercised honest and honest in

dependent business judgment"; that "such matters were matters properly for said Board and properly the subject of the exercise by it of its said independent business judgment" [Rec. XXVII, p. 617], and disposed of said purported accounting claims under the Business Judgment Rule.

Summary of Argument

This Is Not a Proper Case for the Writ to Issue.

[illegible] rest on strictly factual determinations or strictly state law determinations. By policy and precedents this Honorable Court will not review the findings of fact or decisions on matters of state law, made by the District Court and affirmed by the Court of Appeals [illegible] the absence of unusual circumstances, which are not present herein.

[illegible] properly decided that the lease was valid and all amendments thereto were valid and assignable, and this determination has not in fact been contested either in the Court of Appeals or in this Honorable Court.

[illegible]

ARGUMENT.

I.

The Petition Presents No Questions Justifying a Hearing by the Supreme Court of the United States; the Questions Presented Are Either Strictly Factual or Strictly Matters of State Law; on All Such Issues, Both Courts Below Have Concurred.

A. The Two Key Issues Have Been Fact Issues; They Call for No Rehearing in This Court.

Court found, as a fact, that these matters were "properly the subject of the exercise by the Board of Directors of Warner Bros. of its said independent business judgment" that the board of directors "acted in good faith, without fraud, coercion or domination of any person or persons whatsoever," and that the decision of the board not to lend its sanction to any litigation or proceedings based on said alleged accounting errors, was the exercise by the board of "such independent business judgment" [Find. XXVII, R. 617]. This finding likewise was affirmed by the Court of Appeals [Appendix B].

This court should not be used and will not permit itself to be used, as a mere rehearing tribunal on plain factual issues on which the District Court and the Court of Appeals fully concurred.

> "A sure guide and well-established rule of this court makes concurrent findings of two courts below final here in the absence of very exceptional showing of error." *Comstock & Co. v. Group of Investors*, 335 U. S. 211, 215 (1947).
>
> "A court of law, such as this court is, rather than a court of equity, in reviewing findings and fact finding cannot undertake to review concurrent findings of [illegible] in the absence of a very obvious and exceptional showing of error." *Graver Tank & Mfg. Co. v. Linde Air Products Company*, 336 U. S. 272, 274 (1949).

B. **Such Legal Issues as Are Presented by the Petition Involve Strictly State Law Questions: Both Lower Courts Have Fully Concurred on the Rulings.**

There are no federal questions in this diversity case. The sole issue depends upon the determination and application of state law.

In *Cities Service Co. v. Dunlap et al.*, 337 U. S. 341 (1948), this court, in dealing with the subject of minority stockholder suits, unequivocally stated contrary to Petitioner's misleading quotation from this case:

> "We conclude the State has ample power over this type litigation . . .
>
> ". . . the wisdom and policy of this and similar statutes are involved in controversies widely debated in legal literature, but are not for us to judge and are not for us to remark upon." [p. 350.]

This honorable court has, by tradition and policy, consistently held that, in absence of very special circumstances, it would defer to determinations of local law made however only by the District Courts and the Courts of Appeals. *Woodbine Co. v. Muskogee Co.*, 340 U. S. 183, 190 (1950). "We of course usually accept state law as declared by the Court of Appeals"

[illegible] 834, 39 and his brief in the Court of [illegible] the question of which state's law should [illegible] and which was correctly determined by the District Court [illegible] the laws of the states concerned is essentially the same [illegible] such a "conflicts of law" question would [illegible] state law under the forum, California (*Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U. S. 487 [1941]).

citations omitted) and we have no hesitation in doing so here when there is no indication that its conclusion as to state law is not correct."); *General Box Co. v. U. S.*, 351 U. S. 159, 165 (1955) ("We ordinarily accept determinations of Courts of Appeals on questions of local law and we do so here"); *Kapan v. Merchants Transfer Co.*, 337 U. S. 530, 534 (1948) ("We ordinarily accept the determination of local law by the Court of Appeals and will not disturb it here [citing cases]"); *Penn Mut. Ind. Ins. Co. v. Commissioner*, 335 U. S. 701, 708 (1948) "it is sufficient for us to say that we think reasonable arguments can be made based on Pittsburgh cases to support a determination of this question either for or against petitioner's contention. Under these circumstances, we will follow our general policy and not have undisturbed the Court of Appeals' holding as to [state law]." See also the recent cases of *Lumpkin v. Sheppard*, 358 U. S. 588 (1958) and *Gen. Atl. Ins. Co. v. Hakeki*, 358 U. S. 613 (1958).

[illegible] rule [illegible] this Court to accept the [illegible] made by the lower courts [illegible] this Court has [illegible] when such issues [illegible] As stated [illegible] *Mut. Life Ins. Co. v. Hurdt*, 354 U. S. 118, 120 (1957): "The Supreme Court, moreover, has always refused to exercise its discretion to accept every Court of Appeals decision alleged to conflict with applicable local law on the ground that application of state statutes and rules to diverse factual patterns [illegible] Unless the Court of Appeals [illegible] the Court is ready to give scant consideration

tion to a certiorari petition based upon such a conflict. The court uniformly declines review whenever the Court of Appeals has reached a reasonable and permissible result." See *McGregor v. State Mutual Co.*, 315 U. S. 280 (1942).

Petitioner, in attempting to create an aura of federal interest about his petition, has quoted indiscriminately from numerous federal cases. A careful reading of these cases shows, without room for doubt, that none of them is in point and that such quotations are out of context, or from dissenting opinions, or otherwise misleading. For example, Petitioner's lengthy quotation from *Cohen v. Beneficial Loan Corporation, supra*, seems to infer that the decision contained a ruling extending the protection accorded to minority stockholders. In fact, the case involved a state statute which was designed to protect corporations from "strike suits" brought by shareholders. This court upheld the right of a state to pass such legislation and then indicated it would be inappropriate for this court to pass on the wisdom of such legislation. This court stated, with respect to the remedy of a shareholders' derivative suit:

> "Unfortunately, the remedy itself provided opportunity for abuse, which was not neglected. Suit was sometimes brought not to redress real wrongs, but to realize on their nuisance value. They were bought off by secret settlements in which any wrongs to the general body of shareowners were compounded by the suing stockholders, who were well fed by payments from corporate assets. These litigations were aptly characterized in professional slang as 'strike suits' [page 548]".

This court further stated [at page 552]:

> "A *state* may set the terms on which it will permit litigation in its courts." (Emphasis added.)

Petitioner cites and quotes from *Koster v. Lumbermen's Mutual*, 330 U. S. 518, 538, but petitioner fails to indicate that he is quoting from a dissenting opinion. *North American v. Securities and Exchange Comm.*, 327 U. S. 686 and *United States v. Union Pacific Railroad*, 225 U. S. 123, cited by Petitioner, deal only with certain presumptions created under special *federal* statutes (concerning anti-trust and public utility holding company law) and have no conceivable relation to the issues of *state* law in this case. Similarly, *Woods v. City Bank*, 312 U. S. 262 and *Pepper v. Litton*, 308 U. S. 295 are concerned with proceedings under *federal* law (bankruptcy).

II.

In Any Event the Concurring Decisions of the District Court and the Court of Appeals on All Issues of the Case Are Clearly Correct; and This Petition Should Be Denied.

A. The Original and Basic Issue—the Validity of the Contract and Its Amendments—Is Essentially a Factual Issue; It Was Unequivocally Decided Against Petitioner by the District Court; the Court of Appeals Affirmed; on This Fundamental Issue Petitioner Has in Fact Conceded by Default.

As already explained above, the entire gravamen of Petitioner's complaint filed in the District Court in California in 1948 was the charge that the original contract and its amendments between Warner Bros. and United Artists Corporation, as the result of a fraudulent conspiracy between the brothers Warner, and the

remaining members of the Board of Warner Bros. and was unfair and unreasonable.

In 1953, the District Court, while disposing of the earlier question of federal jurisdiction, found that "the contract in controversy was made and entered into in good faith and without fraud . . . ." [Find. IV, R. 75]. This finding was sustained by the Court of Appeals in 1956.

In 1958, after the trial was resumed (following the decision of the question of federal jurisdiction), the District Court found "that the contracts, amendments and agreements . . . and each and all of them, were made and entered into in good faith and without fraud and were fair and reasonable . . ." [Find. XXV, R. 613].

These findings of the District Court in 1958 were so obviously supported by the evidence that Petitioner has not even contested them; his Briefs in the Court of Appeals, following the 1958 District Court judgment, nowhere challenged these findings as unsupported by the evidence. The petition for writ of certiorari filed by Petitioner herein likewise contains no challenge whatsoever to these findings.

B. The District Court and the Court of Appeals Properly Applied the "Business Judgment Rule" to the Claims Based on Certain Alleged Accounting Errors.

1. *The District Court's Findings of Fact on This Issue Were Sustained by the Court of Appeals, and Are Not Even Challenged Here by Petitioner.*

At the trial in 1958, the District Court decided that the alleged accounting errors raised by Plaintiff for the first time in said 1958 trial, were properly the sub-

ject of the "Business Judgment Rule," and, in that connection, made the following findings of fact:

"The Court finds that at the time of the adoption of said resolution, the Board of Directors of Warner Bros. consisted of nine members of whom eight were present; that seven, only, of said members considered the matters referred to by the plaintiff herein, and the report of the Board's investigation thereon, and voted thereon. That the members of said Board of Directors who voted were Charles Allen, Jr., Waddill Catchings, Stanleigh P. Friedman, Benj. Kalmenson, T. J. Martin, R. W. Perkins and Serge Semenenko. That the defendant, Jack L. Warner, a member of said Board, was not present at said meeting; that his brother Albert was present, but did not participate in the discussion or vote with reference to such matters.

"The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment." [Find. XXVII, R. 616-17].

On the appeal to the Court of Appeals, Petitioner attempted to challenge these findings as unsupported by the evidence. The Court of Appeals sustained the findings of the District Court. [Appendix B].

In his Petition for Writ of Certiorari herein, Petitioner nowhere contends that the findings of fact on the Business Judgment Rule are unsupported by the evidence.

(2) The Local Law of the State of Incorporation Clearly Applies the Business Judgment Rule.

The local law governs all matters of substance in diversity cases: such local law is the federal courts' statutes, if any, but the decisions of the state courts as well. *28 U. S. C. 1652; Erie Railroad v. Tompkins*, 304 U. S. 64 (1938). Which state's law is controlling is determined by the conflicts law of the forum: here California. *Klaxon Co. v. Stentor Electric Manufacturing Co., supra.* The District Court correctly applied the California conflicts law in determining the applicable substantive law, and Petitioner's citations to attempt to show that the substantive law of Delaware should apply are not California cases[5] and do not deal with California conflicts law, and are of no relevance. In any event,

---

[5]The District Court decided the conflicts of law question by specific reference to relevant California law [R. 807]. Although petitioner did not press this argument below, he cites two cases in his petition here to establish that the law of Delaware, the state of incorporation, should control. The first of these cases is *Havens v. Guaranty Trust Company*, 288 U. S. 123 (1932). It should be noted at the outset that this case was decided before *Erie v. Tompkins, supra*, which established the controlling nature of state law and before *Klaxon Co. v. Stentor Electric Manufacturing Co., supra*, which established the rule requiring that the conflicts of law rules of the forum should be applied. Moreover, in the *Havens* case and in the case of *Perlman v. Feldmann*, 219 [illegible] involved were characterized as "internal affairs" of the corporation—matters strictly between the shareholders and directors with no outside parties involved. Clearly, those issues are of a different nature than those here being contested, which involve contractual relations between the corporation and outside parties. In any event, as already indicated, it is the California conflicts rules which govern, and the District Court correctly determined

there would be no occasion for any dispute over which state's law should here apply. The laws of the states of California, Delaware and New York, equally apply the Business Judgment Rule. *Findley v. Garrett*, 109 Cal. App. 2d 166, 240 P. 2d 166, 240 P. 2d 421 (1952); *Davis v. Louisville Gas & Elect. Co.*, 16 Del. Chanc. 157, 142 Atl. 654; *Blaustein v. Pan American Petroleum and Transport Co.*, 293 N. Y. 281, 56 N. E. 2d 705; *Hornstein v. Paramount Pictures Inc.*, 37 N. Y. S. 404 (1942).[3]

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[3]Petitioner cites a number of Delaware cases in a seemingly half-hearted attempt to indicate that the law of Delaware does not recognize the business judgment rule. Even if the Delaware law were applicable (and it is not), petitioner's cases do not support his argument. He quotes at great length from the case of *Gottlieb v. Hayden Chemical Corporation*, 33 Del. Chanc. 82, 87, 90 A. 2d 660 (1952). The material that he neglects to quote, coming directly before the material that he does quote, indicates the baselessness of his contentions. The court stated [at p. 663]:

> "We recognize the force of the universally acknowledged principle of law which leaves many matters to be finally settled by the sound business judgment of the directors . . ."

The court then went on to note that in the case before it, the majority of the directors had enriched themselves by the actions complained of. In the case of *Yeaw v. Bellesey*, 27 Del. Chanc. 381, 30 A. 2d 808, cited by petitioner, the court accepted as a fact on demurrer that the corporation had "no officer or director with an uncontrolled and unbiased mind." This case is clearly opposite to the present situation where the finding is exactly to the contrary. The other case cited by petitioner from Delaware, *Frankel v. Donovan*, 130 A. 2d 511, is basically the same in nature as the case of *Gottlieb v. Hayden Chemical Corporation*, *supra*.

That the Business Judgment Rule is applied in Delaware is made unequivocally clear in *Davis v. Louisville Gas & Electric*, *supra*:

> "The reason which courts advance for such application is that it is not their province to resolve what are really questions of policy and business management. The directors are chosen to pass upon such questions and their judgment, when shown to be tainted with fraud, is accepted as final. The judgment of the directors of corporations enjoys the benefit of the presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve" [p. 660].

C. The Business Judgment Rule Is Clearly Applicable and Was Properly Applied.

The Business Judgment Rule, stated plainly, is this: where the Board of Directors of a corporation acts in good faith and free from domination, the court will not, in a minority stockholders' suit, supersede the Board of Directors' judgment with the judgment of the court.

It would be difficult for business in this country on the one hand, and for the courts in this country on the other, to function if every corporate business judgment, however honestly and freely arrived at, would be subjected to judicial reversal at the instance of a minority stockholder who claimed the judgment was wrong.

The leading case in California, indeed one of the leading cases on this matter in the United States, is *Findley v. Garrett* (1953), 109 Cal. App. 2d 166, 240 P. 2d 421. In that case the court said [p. 174]:

> "The power to manage the affairs of a corporation is vested in the Board of Directors. (*Scott v. Los Angeles Mountain Park Co.*, 92 Cal. App. 258, 264 [267 P. 914].) Where a board of directors, in refusing to commence an action to redress an alleged wrong against a corporation, acts in good faith within the scope of its discretionary power and reasonably believes its refusal to commence the action is good business judgment in the best interest of a corporation, a stockholder is not authorized to interfere with such discretion by commencing the action."

Findley v. Garrett, has been followed in subsequent California cases and is clearly the present law of California:[4]

> *Thomas v. Summers Gyroscope Company* (1958), 160 Cal. App. 2d 234, 324 P. 2d 893;
>
> *Olson v. Basin Oil Co.* (1955), 136 Cal. App. 2d 543, 288 P. 2d 952.

In general, petitioner's attack on the application of the Business Judgment Rule by the District Court (and affirmed by the Court of Appeals) consists of the following:

(a) *Petitioner Repeatedly Contends That the Rule Should Not Be Applied When the Board Is Not Free and Not Independent. On This There Is No Conflict. We Consider This to Be Part of the Rule Itself.*

But in this case, the District Court has found twice [1953 Find. IV. R. 74-75; 1958 Find. II. R. 602] that the Warner Board was free and independent. The

[4] Petitioner cites three cases from California as being contrary. Only one of these cases, *Wickersham v. Crittenden*, 93 Cal. 17 (1892), involved a shareholders' derivative suit. Moreover, that case contained allegations that only two out of the five directors approved the actions complained of and further allegations that the board of directors was not properly constituted, elected, or [illegible] *Heaton v. Marshall*, 166 Cal. 185 (1913), cited by petitioner does not involve a shareholders' derivative suit but, on the contrary, was *brought by the corporation* against a director, claiming that he made secret profits without the knowledge of the other directors. *Kennerson v. Burbank Amusement*, 120 Cal. App. 2d 157 (1953), also did not involve a shareholders' action. This was a case in which a plaintiff tried to enforce a contract with the corporation; the corporation, *acting through its board of directors*, argued it was void; that situation is the exact opposite of the situation now before the court.

Court of Appeals on the first appeal, reviewed the record and found no occasion for reversal on the facts [R. 669] and again affirmed the comparable findings on the second appeal. [See Appendix B, opinion of Court of Appeals.]

(b) *Petitioner Contends That "Effective Working Control" of the Corporation or "Working Stock Control" of the Corporation Are the Same as "Domination" of the Board of Directors, and Means That the Board Is Unable to Exercise Any Free or Independent Judgment by Reason of Such Control.*

This contention is unsound.

One of the clearest analyses of the distinction between these concepts is from an earlier case in the Ninth Circuit: *Cowell v. McMillen* (9th Cir., 1910), 177 Fed. 25.

In the *Cowell* case, Cowell sued McMillen derivatively in the name of the Tacoma and Roche Harbor Lime Company, alleging that McMillen owned the majority of the stock of the corporation, and elected directors who, because McMillen elected them, obeyed his directions in operating the corporation to his benefit and to the corporation's detriment. There were further allegations that the directors voted excessive salary to McMillen, fraudulently issued bonds to McMillen and that he used the assets of the corporation to his personal advantage and to the advantage of another corporation owned by him. It was also alleged that he entered into a leasing contract with the corporation unfair to it and to the benefit of his privately owned corporation. The court, after first noting that Mc-

Millen was not a majority shareholder at the time the original contracts were made, agreed that he was a majority shareholder at the time the contracts were renewed. The court then stated, at page 42 of the opinion:

> "It is insisted, however, that the directors were dummies when they voted for the renewals, because they were elected by the vote of McMillen, the holder of the majority of the shares of stock. In the sense that they owed their positions as members of the board to McMillen, complainant is correct; but, in the sense that they were mere creatures, willing or obligated to do McMillen's bidding, and to aid him in executing fraudulent designs, or knowingly to do any act beyond the law, or that was unfair or oppressive, or against the defendant company's interest, the contention is without merit."

There are thousands of public corporations in this country in which there are stockholding groups of sufficient size and character to permit such groups to elect a majority of a board of directors. Countless men of integrity—lawyers, business men, doctors, engineers, bankers and others—accept positions on boards of directors at the suggestion of such groups able to elect a majority of the board. Does this mean that any person who under these circumstances consents to become a member of a board of directors has *ipso facto* become a fraud, a person who has no integrity, and who would automatically be dominated to vote to approve any fraudulent act perpetrated on the corporation by the stockholders who elected him to the directorate; that he will become part of a conspiracy to per-

mit the stealing of funds and assets from a publicly held corporation?

Consider the incredible enormity of the position which petitioner asks this court to take. Here the District Court has found, not that there was insufficient evidence to show domination, but has found affirmatively that:

> ". . . the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever . . ." [Find. XXVII, R. 617].

The Court of Appeals sustained this finding. Nowhere in his petition for writ of certiorari has petitioner argued that this finding was unsupported by the evidence. What petitioner appears, in reality, to be arguing is that this court should establish a presumption, as the law of the land, that any person who is elected to a directorship of a public corporation by the votes of another person or group of persons is, thenceforth, deemed to be dishonest and corrupt. Indeed, in asking this court to disregard the findings of the District Court in this case, petitioner is, shockingly, asking this court to establish a *conclusive* presumption of dishonesty and corruption. Such a pronouncement would sever the very roots of our fundamental concepts of law in this country; and it would be an unthinkable misrepresentation of the basic integrity of its people.

A case passed upon by this court with interesting parallels to the one at hand is *Comstock v. Group of Investors*, 335 U. S. 211 (1947). In that case, the petitioner was a shareholder in a subsidiary of a railroad company. The companies had been in reorganization under Section 77 of the Bankruptcy Act and a plan of

reorganization had been approved by the Interstate Commerce Commission. The petitioner objected to the approval of the plan contending that the parent had dominated and controlled the subsidiary and had mismanaged its affairs to the detriment of the subsidiary. The petitioner urged, therefore, that a large claim of the parent against the subsidiary should not be allowed as was proposed in the plan of reorganization. This court first reprimanded the petitioner for departing from his assurances that there was no *factual* controversy—noting that his arguments were essentially of a factual nature with respect to domination and control, and the effect thereof. This court then noted that it had discussed remedies for breach of fiduciary duty in cases such as *Pepper v. Litton*, 308 U. S. 295 (cited by petitioner in this case) but that

> ". . . petitioner asks us to declare the same result in this case, despite explicit and unchallenged findings that in its dealings with the (subsidiary) during the period involved, the (parent) acted in good faith and with due regard to its obligations, legal and equitable, to the subsidiary and its securities holders. [P. 228].
>
> ". . . it is not a mere existence of an opportunity to do wrong that brings the rule into play; it is the unconscionable use of the opportunity . . ." [P. 229].

As is true in this case, this court further noted that the criticized transactions were "beneficial rather than injurious to the interests which now challenged them." [P. 230]. This court also finally said:

> ". . . The findings to that effect are entitled to special weight where as here, they are based on

> the district judge's complete familiarity with the case [citing cases]. Affirmed by the Circuit Court of Appeals, they are, under the rule concerning concurrent findings, and on the basis of our grant of certiorari, conclusive in this court." [p. 230].

(c) *Petitioner Contends That the Business Judgment Rule is Not Applicable Where Fraud (Including Breach of Trust, Divided Loyalty and the Like Is Involved).*

The leading California case of *Findley v. Garrett, supra*, disposes of this contention. In the *Findley* case, the complaint alleged fraud (including divided loyalty charges, etc.). The court, stated:

> "Directors have the same discretion with respect to the prosecution of claims on behalf of the corporation, as they have in other business matters. In this respect, the fact that a claim may be founded in fraud does not differentiate it from other claims. . . . Refusal to sue on a fraud claim is not, as plaintiff contends, a ratification of fraud. . . ." [109 Cal. App. 2d at 177.][5]

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[5]Petitioner cites *Bayer v. Beran* (1944), 49 N. Y. S. 2d 2, as purportedly stating an exception to the Business Judgment Rule which makes the Rule inapplicable in cases where some of the members of the board of directors have so-called "divided loyalty." The actual basis of the decision of the court (which was a decision of a *state* trial court) is not entirely clear. See, for example, the statement at page 15 of the court that "on the entire case, the directors acted in their free exercise of their business judgment. . . ."

To the extent that *Bayer v. Beran* purports to make such an exception as petitioner contends for, it is not in keeping even with the law of New York. See *Lasdon v. Lasdon* (1945), 50 N. Y. S. 2d 800, 268 App. Div. 455, a later New

(d) *Petitioner Distorts the Facts to Contend That a "Gift" is Here Involved.*

Petitioner's frequent innuendoes and assertions that there were "gifts" in this case are a baseless canard. As pointed out above, at the end of the 1958 trial, petitioner, for the first time, asserted certain accounting errors. Petitioner's principal accounting arguments were so involved that they required complex charts, prepared by a certified public accountant, hand picked by petitioner; and such charts were based on self-supporting assumptions of contract interpretation which were supplied to such accountant by petitioner. We deny the validity of petitioner's claims of accounting error. But to say that a corporation, if it were in error in the course of a good faith resolution of an accounting problem, is making a "gift" is plainly contrived and fanciful. Coupled with petitioner's further suggestion that a gift is "ultra vires," the result would be complete chaos in the business life of this country. Thousands of corporate transactions every day, involving good faith resolutions of differences with third parties, or merely involving good faith determinations of accounting practice, would never have finality; on petitioner's contention that if there was an error, then there was a "gift," any stockholder could require a judge to impose his view of the correctness of a good faith business determination. Petitioner's contention is a complete distortion of the concept of "gift," and would virtually emasculate the

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York *appellate* decision which involved so-called divided loyalty and in which the court applied the Business Judgment Rule, commenting about its proper application where a majority of the board expressing its judgment is honest and free of domination.

In any event, the California decision of *Findley v. Garrett*, [illegible] is both correct on principle, and controlling.

well-founded and vitally necessary Business Judgment Rule. Neither logic, public policy nor authorities support petitioner's contention.

(c) *Petitioner Makes Several Other Passing Objections to the Application of the Business Judgment Rule Which Can Be Disposed of Summarily.*

Petitioner contends that the rule was unfairly applied because he was *compelled* to submit his newly alleged accounting claims to the current Warner Bros. board of directors.

It is very clear from the record that the court *did not order* petitioner to make any such submission. At page 786 of the record, the court states: "I am not directing it to be done. I am offering you the opportunity to do it. I offer either party the opportunity to do it and to await judgment until it be done."

Petitioner further charges unfairness to the District Court by implying that the District Court ruled adversely on a request actually made by Petitioner to bring the directors in to testify following the aforesaid submission. Petitioner's references to the record in this connection indicate a running colloquy with the court on this matter; however, petitioner *never* moved the court for permission; the District Court, accordingly, made no ruling, formally or informally [R. 761-786].

D. Regardless of the Business Judgment Rule, the Petitioner Could Not Have Prevailed in His Alleged Accounting Claims; the Record Clearly Demonstrates That the Transactions Complained of Were Fair and Reasonable.

In this brief in opposition to granting the writ of certiorari, it would be impracticable to go into the fairness of the accounting transactions complained of. If it

were necessary, however, the court's attention is directed to the record of the case, which we believe will unequivocally establish the complete fairness and reasonableness of all of such transactions.

Conclusion.

It is respectfully submitted that the petition before this court presents no new issues, nor any issues of general interest; that it does present only issues of fact and local law; that even on these, the petition is clearly without merit; and that therefore petitioner has made no showing that he is entitled to the issuance of the writ.

> "The jurisdiction (of the Supreme Court to review cases by way of certiorari) was not conferred upon this court merely to give the defeated party in the circuit court of appeals another hearing."
>
> *Mangmun v. Coty*, 262 U. S. 159, 163.

Respectfully submitted,

OLIVER B. SCHWAB,

HAROLD S. KANT,

Counsel for Respondents, United States Pictures, Inc. and Milton Sperling.

APPENDIX A.

RULE 54.

JUDGMENTS; COSTS

"(c) *Demand for Judgment.* A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment. Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings."

RULE 23.

CLASS ACTIONS

"(b) *Secondary Action by Shareholders.* In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

APPENDIX B.

United States Court of Appeals for the Ninth Circuit.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant vs. Milton Sperling, *et al.*, Appellees. No. 16,387. April 20, 1960.

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Chambers, Magruder and Jertberg, Circuit Judges.

Per Curiam.

This case was up on appeal previously, Smith v. Sperling, 237 F. 2d 317 (C. A. 9th, 1956), rev'd 354 U. S. 91 (1957).

It started by the filing on December 15, 1948, of a typical minority stockholder's derivative suit brought by the plaintiff, a citizen of New York, against Warner Bros. Pictures, Inc., and United States Pictures, Inc., both Delaware corporations, and against certain named individuals, Harry M. Warner, Jack L. Warner, and Milton Sperling, all citizens of California. Sperling was the son-in-law of Harry M. Warner. Originally the complaint contained three causes of action, but the third suit was dismissed without prejudice several years ago, and we are now concerned only with the first and second causes of action.

The first, brought against all the defendants, charged that a certain contract for the production of motion pictures, and subsequent modifications thereof, had been made improperly by Warner Bros. Pictures, Inc., with United States Pictures, Inc., as a result of domination of the former corporation by the stock control of the

Warner brothers, for the purpose of enriching United States Pictures, Inc., and its president, Milton Sperling, at the expense of Warner Bros. Pictures, Inc. The relief sought was the cancellation of the contract. This relief has now become moot with the expiration of the contract, and what the minority stockholder is presently seeking is a financial reimbursement to Warner Bros. Pictures, Inc., for errors or misrepresentation of the contract during the time it was being administered.

After a lengthy hearing, the district court found as a fact that though the individual defendants, the Warner brothers, had sufficient stock ownership to control the election of the directors of Warner Bros. Pictures, Inc., such directors were not, as alleged in the complaint, "dominated" by them, but had approved the contract in good faith and in the exercise of their independent business judgment as being a sound business arrangement for the best present and future interest of Warner Bros. Pictures, Inc. Therefore the district court thought that, so far as the first cause of action was concerned, Warner Bros. Pictures, Inc., should be realigned as a party plaintiff, and as thus realigned there would be no diversity of citizenship. Hence the district court entered an order dismissing the first cause of action for lack of jurisdiction. Smith v. Sperling, 117 F. Supp. 781 (S. D. Cal. 1953).

The second cause of action was different in that United States Pictures, Inc., was not named as a defendant, and the complaint charged mismanagement of Warner Bros. Pictures, Inc., by the individual defendants as officers and directors of the corporation, all to the large pecuniary loss of the corporation. This cause of action the district court also dismissed, but on the merits for lack of equity.

On appeal this court thought the district court was right as to the first cause of action, but reversed its action as to the second and remanded the case to the district court for trial on the merits of the second cause of action. 237 F. 2d 317. Upon certiorari issued by the Supreme Court, that Court held, as to the first, that whether or not the directors of Warner Bros. Pictures, Inc., were "dominated" by Messrs. Warner, as to which the Supreme Court of course did not undertake to decide, nevertheless if the corporation through its board of directors refused to bring a suit, even though the directors were acting independently and in good faith, it was improper for the district court to realign the corporation as a party plaintiff and thus to defeat the federal jurisdiction. Accordingly, in reversing our determination, the Supreme Court remanded the case to the district court for trial of the first cause of action on the merits. 354 U. S. 91.

Because there was some overlapping of the jurisdictional issues as conceived by the district court and the issues on the merits, the earlier trial in the district court was very extensive. It was stipulated that all the evidence taken at the first trial should be considered on the merits.

The district court, pursuant to the remand, resumed its hearings and much further evidence was offered and received. Appellant offers no objection that any evidence on his behalf was improperly excluded. Finally, on December 17, 1958, a new set of findings was issued by the district court, and judgment was entered on the basis of these findings dismissing both the first and the second causes of action on the merits. The judg-

ment now on appeal specifically contained a clause stating that:

"[T]his judgment of dismissal shall not operate as an adjudication upon the merits as to any claims arising from alleged non-performance or breach of any contract, or amendment or supplement thereto, between Warner Bros. Pictures, Inc., and United States Pictures, Inc.; nor as to any claim arising from the payment by Warner Bros. Pictures, Inc., of $78,000 as 'severance pay' to Joseph Bernhard."

On the findings of fact by the district court, which seem to us to be adequately supported by the evidence, we think that the district court's judgment of dismissal was inevitable and correct. There is no doubt that the production contract with United States Pictures, Inc., proved in operation to be very lucrative to Warner Bros. Pictures, Inc. Under the contract, Warner Bros. Pictures, Inc., received and handled all the gross receipts from the exploitation of the pictures and allocated the same in accordance with its terms. There was testimony by an employee of Price, Waterhouse & Company, independent auditors for both corporations, that the accounting practices of each were in accordance with the practices acceptable in the industry. Appellant does not claim that defendant, United States Pictures, Inc., diverted to improper uses any of the gross receipts. The trial judge found, as he had in substance found previously, as follows:

"The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the

interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment."

A judgment will be entered affirming the judgment of the District Court.

(Endorsed) Per Curiam Opinion Filed April 20, 1960.

Frank H. Schmid, Clerk.